

REPUBLIC OF SOUTH AFRICA



**IN THE HIGH COURT OF SOUTH
GAUTENG DIVISION, JOHANNESBURG**

AFRICA

CASE NO: 2020/35790

Reportable: Yes Of interest to other judges: Yes 7 March 2023 Vally J
--

In the matter between:

HENQUE 3935 CC
t/a PQ CLOTHING OUTLET (in Business Rescue)

Applicant

and

THE COMMISSIONER FOR THE SA REVENUE SERVICE

Respondent

JUDGMENT

Vally J

[1] Can the Commissioner for the South African Revenue Service (SARS) set-off a tax liability of a company against the VAT refunds due to the company in circumstances where the tax liability concerns a period prior to the company entering into business rescue, but was only determined after the company had already entered into business rescue? That in essence is the question raised for determination here.

[2] The answer to this question lies in the construction of the relevant sections of the Companies Act 71 of 2008 (Companies Act), the Income Tax Act, 58 of 1962 (Income Tax Act) and the Tax Administration Act, 28 of 2011 (TAA).

[3] The applicant, Henque 3935 CC (Henque), says it is unlawful for SARS to do so. SARS says otherwise. Consistent with its contention Henque calls on this court to declare (i) that the 2017 additional assessment of its tax liability dated 4 April 2018 is a pre-business rescue debt and, (ii) SARS is prohibited from collecting the 2017 additional assessment by applying set-off against Henque's VAT refund payments due for the period 02/2018 to date.

[4] Henque is a close corporation. Section 5(1)(d) of the Income Tax Act requires it to pay tax on its income earned or accrued during each of its financial years. The tax is payable for the specific year that the income was earned. The tax is owed once the financial year is completed. Thus, Henque is required to furnish SARS with a return indicating the profit it has earned as well as self-assess the tax liability arising from the said profit. It is required to pay the tax over to SARS. The onus is on Henque to honestly and correctly assess its tax liability and to pay over the amount it believes is owed to SARS. It filed a tax return for 2017 with SARS where it claimed to have made a loss of R46 000.00. It was therefore not obliged to pay income tax. At the same time, it had accumulated tax credits for VAT and was therefore entitled to a refund. In terms of s 96 of the TAA, SARS would then issue a notice of assessment on the tax liability, which would specify the amount to be paid as well as the date when payment should be made. On 29 November 2017 SARS issued a notice of assessment in which it recognised that Henque was due a refund.

The assessment was based solely on the claims made by Henque in its return. In the same notice, SARS informed Henque that it was to be subjected to an audit.

[5] One of the innovations of the Companies Act is to be found in Chapter 6 thereof, where the concept or practice of business rescue is introduced into our law. In terms of Section 128(1)(b) of the Companies Act, business rescue is a 'proceeding' that is designed to 'facilitate the rehabilitation' of an entity that is financially distressed by (i) temporarily appointing a Business Rescue Practitioner (BRP) who supervises and manages the affairs of the entity; (ii) placing a temporary moratorium on the rights of claimants against the entity or against any 'property' in the possession of the entity – the full extent of the moratorium is further elaborated upon in s 133 of the Companies Act; and, (iii) allowing for a business rescue plan (the plan) to be developed. By placing a temporary moratorium on the rights of claimants, the Companies Act ring-fences the debts of the entity that have accrued prior to the commencement of business rescue. It is these debts that the plan would focus upon to 'rehabilitate' or 'rescue' the entity. Sections 151 and 152 of the Companies Act provide for the plan to be tabled at a meeting of the creditors for adoption. In cases where the plan adopted by the creditors affects the rights of shareholders or members, as in this case, then the plan would have to be tabled at a meeting of these shareholders or members for their approval of the adoption. Should the plan be adopted, and approved (in the case where approval is necessary), in terms of s 152(4) it is binding on all creditors regardless of whether a creditor was at the meeting or not. Finally, in terms of s 154(2), no creditor, including SARS, if owed unpaid taxes which were due and payable pre the commencement of business rescue, can enforce the debt except in terms of the

plan. Post commencement debts – referred to as ‘Post-commencement finance’ in the Companies Act - are an altogether different species. They are dealt with in terms of s 135 of the Companies Act. They are not affected or compromised by the plan. Salaries earned by employees during the business rescue proceedings constitute post-commencement finance. Any taxes, such as income tax arising from post-commencement profits, Skills Development Levies (SDL) or VAT on post-commencement sales for example, too, would constitute post-commencement finance. All post-commencement finance has to be settled before any pre-commencement debts can be considered.

[6] Henque commenced business rescue on 31 January 2018. The decision to commence with business rescue was voluntarily taken by its sole member. The first meeting of creditors and employees was held on 12 February 2018.

[7] In terms of s 92 of the TAA, SARS is obliged to make an additional assessment if the original assessment ‘does not reflect the correct application of a tax to the prejudice of SARS or the fiscus’. In this case, the original assessment was based solely on the return of Henque. Once the decision to conduct an audit of Henque’s financial affairs was taken and conveyed to Henque on 29 November 2017 the likelihood of an additional assessment was no longer a theoretical possibility, it became real. The BRP, therefore, knew or had to have known that the audit was still taking place when Henque commenced business rescue. He knew or ought to have known that the tax liability of Henque for the 2017 year had yet to be determined.

[8] The audit was only completed on 4 April 2018. It revealed that Henque's claim that it had made a loss during the 2017 year was false. In fact, the audit revealed that Henque had actually produced a taxable income of R16 793 724.00 for the 2017 year. The additional assessment was issued to Henque on 1 May 2018. On the same day an employee of SARS informed the BRP that Henque's income tax liability for 2017 was R5 334 123.13. This amount included penalties and interest. The actual notice reflects the amount payable as R5 620 571.03. It is not clear why the amounts are different, but for purpose of this judgment nothing turns on this.

[9] In terms of s 50 of the Companies Act, the BRP must, after consultation 'with creditors, other affected persons and the management' of the entity prepare a business rescue plan. In this case the BRP published his rescue plan on 31 May 2018. The plan recognised a tax liability for VAT at R2 467 810.00 and for PAYE at R568 728.00 making a total of R3 036 538.00. It appears that the plan did not include the income tax liability for 2017, which by this stage was issued to Henque as an additional assessment. According to the plan, SARS would receive only 15% of its claim. There is a dispute as to whether this plan was served on SARS, but nothing turns on that dispute. It bears mentioning that at the time Henque commenced business rescue it had 31 stores, and the BRP managed to sell 23 of its stores during the business rescue proceedings. The other 17 stores were closed. The sale was for a sum of R23.3m. It took place on 1 June 2018. The plan was adopted by the creditors at a meeting on 13 June 2018. SARS was not present at the creditors' meeting. Those creditors whose claims were accepted by the BRP were paid. Employees were paid for all work done prior to and during the business

rescue process. Many employees were lawfully retrenched and appropriately remunerated or compensated. For some or other reason SARS was not paid.

[10] On 2 August 2018 an employee of the SARS addressed a letter to the BRP stating that SARS was not kept informed of the business rescue process, and that it was in the process of approaching court for an order setting aside the business rescue proceedings. The BRP responded to the letter within thirty minutes. Two aspects of the response are important: (i) he disputed the claim that SARS was not informed of the business rescue process. Hence, a dispute of fact arose between SARS and the BRP as to whether SARS was properly served with a notice of the creditors' meeting and a copy of the plan. Again, this dispute is of no moment; and (ii) the dispute aside, the BRP asked SARS to send a copy of its claim against Henque to him so that 'it can be adjudicated'.

[11] SARS claimed R8 131 225.67 from Henque. The claim consisted of: (i) a VAT claim of R2 840 005.05; a PAYE claim of R20 705,86; (iii) a UIF claim of R104 819.02; (iii) a SDL claim of R64 334.60 and (iv) an income tax claim of R5 101 361.14 – this figure is different from the additional assessment, but, again, nothing turns on it. However, SARS acknowledged that the claim for income tax (R5 101 361.14) though raised on 4 April 2018 was a pre commencement debt. SARS being a concurrent creditor, would have to recover this debt in terms of the plan. As for the rest, SARS adopted the view that these were post-commencement debts. Thus, on SARS' view Henque owed it R3 029 894.53. At the same time, SARS owed Henque a refund of R1 018 820.80 for overpayment of VAT. Henque requested the refund. At first SARS held on to its view that the refund could be set-

off against the R3 029 894.53, but after some exchanges of letters with Henque's attorneys SARS agreed that its view was wrong and that the refund was due and payable to Henque. On 5 April 2019 SARS, in response to a query from Henque as to when payment could be expected, said that it was in the process of being paid. By 2 May 2019 the refund was still outstanding. Henque's attorneys enquired as to when payment could be expected. They were informed, once again, that it was still being processed. By 6 May 2019 it was still not paid. Henques' attorneys enquired from SARS as to when repayment could be expected. They received no response from SARS.

[12] On 13 May 2019, the attorneys wrote again to SARS seeking an answer to their question. On the same day Henque received an email from SARS informing it that SARS had reverted to its initial position, i.e. that the VAT refund would not be paid as it had been set-off against the income tax liability of Henque. SARS drew Henque's attention to the fact that as at 13 May 2019 Henque's tax liability amounted to R5 334 123.13 while the VAT totalled R1 217 589.30 (which included the refund of R1 018 820.80 which SARS had conceded was due to Henque). SARS claimed that the income tax for the 2017 year had only become due and payable on 31 May 2018 when the additional assessment with regard thereto was completed. This liability constituted a post commencement debt¹. And so, it said that in terms of s 191 of the TAA it was entitled to set-off the VAT refund from the amount owing to it. SARS' latest stance was a complete *volte face* from its earlier one. Henque disagreed with this view and objected to the decision to set-off the refund against the income tax liability for the 2017 year. It claimed that that the

¹ The Companies Act does not provide for the concept post-commencement debt, only post-commencement finance. In this case, the parties understood the two terms to mean one and the same thing.

purported set-off was in contravention of s 198(1) of the TAA read with s 154 of the Companies Act. Its attorneys wrote to SARS on 3 June 2019 expressing the view that the fact that the assessment of the income tax was completed after the commencement of business rescue did not alter the more important fact, which was that the liability for the 2017 income tax arose and was due on 28 February 2017. Accordingly, it is a pre-commencement debt. The VAT refund of R1 018 820.80 could not be set-off against it.

[13] Thereafter, further correspondence was exchanged between the parties to resolve the impasse. And to this end, a meeting between the attorneys for Henque and an employee of SARS also took place. But no progress was made. On 18 July 2019, SARS informed Henque's attorneys that it steadfastly held to the view that s 191 of the TAA entitled it to set-off the VAT refund. This position was reiterated on 14 August 2019. As the differences between the parties remained unresolved, Henque instituted the present application.

[14] The Namibian Supreme Court in *Esselmann*² had occasion to consider whether there arises a liability for payment of taxes in circumstances where a proper income tax assessment has yet to be made and served on the person upon whom the liability rests. In considering the question, the court noted that the relevant law – s 5 of the ordinance regarding taxation, which incidentally is similar to s 5 of our Income Tax Act - provided that 'there shall be paid annually for the benefit of the Territory Revenue Fund (the equivalent of our National Revenue Fund) an income tax in respect of the taxable income received by or accrued to or in favour of

² *Esselmann v Secretary of Finance* 1991 (3) SA 681 (NmSC)

... any person³ This provision, the court found, does not mean that the taxpayer is liable for payment of annual income tax prior to such tax being assessed and a notice issued to the taxpayer. The issuing of the notice is crucial. Chief Justice Bekker (with the concurrence of Dumbutshena AJA and Mahomed AJA (who later became the first Deputy President of our Constitutional Court and then our Chief Justice) succinctly summed up the legal position in a single sentence:

‘In my view, s 5 merely established generally the *liability* to pay tax, but does not make tax payable before it has been assessed.’⁴ (Italics in original)

[15] Section 1 of the TAA defines an assessment as:

‘... the determination of the amount of a tax liability or refund, by way of self-assessment by the taxpayer or by SARS’

[16] In terms of s 92 of the TAA, read with s 1 of the same Act, an ‘additional assessment is simply an assessment made by SARS in a circumstance where it is satisfied that an assessment does not reflect the correct application of a tax Act to the prejudice of SARS or the fiscus.’ Thus, an additional assessment is no more than a reconsideration of an assessment when SARS discovers that the assessment prejudiced SARS or the fiscus. We know from s 96 of the TAA that when SARS issues a notice of assessment, as it did in this case⁵, it has to, amongst others, specify the amount to be paid as well as the date for when payment is to be made. Reading s 5(1)(d) of the Income Tax Act in the context of ss 1, 92 and 96 of the TAA it is unquestionably clear that the income tax only becomes due and payable when the assessment or additional assessment is made and issued to the taxpayer.

³ Id at 688C

⁴ Id at 688E

⁵ See [4] above

[17] This is so because for it to be due it has to be liquidated:

‘The ordinary meaning of ‘due’ is that ‘ ... there must be a liquidated money obligation presently claimable by the creditor for which an action could presently be brought against the debtor. Stated another way, the debt must be one in respect of which the debtor is under an obligation to pay immediately.’

And:

‘The word ‘payable’, can have at least two different meanings, viz ‘...(a) that which is due or must be paid, or (b) that which may be paid or have to be paid ... The sense of (a) is a present liability – due and payable - ... (b) a future or contingent liability’. Depending on the context of the statute involved, the word ‘payable’ may refer to ‘... what is eventually due, or what there is a liability to pay’⁶ (Citations omitted.)

[18] Section 96(1)(f) of the TAA, as we have already noted, provides that SARS must issue a notice of assessment which is to include ‘the date for paying the amount assessed’. In this case the additional assessment was made on 4 April 2018 and issued to Henque on 1 May 2018. The notice of the additional assessment identified the ‘due date’ to be 1 May 2018 and the ‘second date’ to be 31 May 2018. The second date is the date by when it is to be paid. The amount assessed, thus, only became due and payable on 31 May 2018. Until then it was not a ‘debt’. Thus it constitutes a post-commencement debt or finance (in the parlance of the Companies Act).

[19] Henque submits that the fact that the additional assessment of the income tax was only issued on 1 May 2018 does not detract from a more fundamental fact: that in terms of s 5(1) of the Income Tax Act the liability for the income tax arose on

⁶ *Singh v Commissioner, South African Revenue Service* 2003 (4) SA 520 (SCA) at [25] and [26] (per the concurring judgment of Olivier JA)

28 February 2017. An assessment, including an additional assessment, of the liability subsequent to 28 February 2017 only quantifies the liability. It does not create the liability. On the basis of the analysis of the various tax legislations and authorities referred to above, I find myself unable to agree with the submission. I hold the view that Becker CJ's single sentence *dictum* concerning liability for income tax applies with equal force to our tax legislations: that s 5(1) of the Income Tax Act only establishes 'generally the liability' but that in terms of the relevant provisions of the TAA (analysed above) the tax became due and payable when the additional assessment was made. Only when it was quantified and became due and payable did it become a debt. The additional assessment constitutes the important event that transforms a general liability into an actual one. Articulating it differently, s 5(1) of the Income Tax Act has to be interpreted in the context of the other relevant legislation, the TAA. On this approach tax liability is recognised as being a mosaic made of various legislations.

[20] To conclude: the 2017 additional assessment is not a pre-business rescue debt. Accordingly, Henque's call for declaratory relief holding otherwise has to be rejected

Costs

[21] The parties correctly adopted the view that costs should follow the result.

Order

[22] The following order is made:

The application is dismissed with costs.

Vally J

Gauteng High Court, Johannesburg

Date of hearing: 18 January 2023

Date of judgment: 7 March 2023

For the applicant: J Peter SC with C Dreyer (initial heads drafted by C Dreyer)

Instructed by: Fluxmans Attorneys

For the respondent: C Dauds

Instructed by: State Attorney